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INCOME TAX –TREATMENT OF GAMBLING GAINS, LOSSES, AND EXPENSES

(Replaces Revenue Administrative Bulletin 1987-3)

Pursuant to MCL 205.6a, a taxpayer may rely on a Revenue Administrative Bulletin issued by the Department of Treasury after September 30, 2006, and shall not be penalized for that reliance until the bulletin is revoked in writing. However, reliance by the taxpayer is limited to issues addressed in the bulletin for tax periods up to the effective date of an amendment to the law upon which the bulletin is based or for tax periods up to the date of a final order of a court of competent jurisdiction for which all rights of appeal have been exhausted or have expired that overrules or modifies the law upon which the bulletin is based.

RAB 2016-3. This Revenue Administrative Bulletin (RAB) describes the distinction between casual and professional gamblers and the appropriate methods for recording and documenting gambling activity, calculating gains or losses, and reporting gambling income.

INTRODUCTION

Michigan taxable income is based on the amount reported on the federal income tax return as adjusted gross income. Casual and professional gamblers calculate adjusted gross income differently from one another. Casual gamblers itemize most gambling losses. Professional gamblers net wagering gains and losses. Therefore, proper characterization of a taxpayer's status as a professional or casual gambler is necessary to properly report gambling income at the federal level. Proper reporting of gambling income at the federal level means that wagering gains of both professional and casual gamblers are reflected on the Michigan return, but only the professional gambler's losses carry over to the Michigan return because the losses are a component of the professional gambler's trade or business income and are included in adjusted gross income. Because a casual gambler's wagering losses are itemized, they are not included in adjusted gross income and do not carry over to the Michigan return.

ISSUES

- I. What constitutes gambling income?
- II. How is income, including losses, from gambling activity reported?

- III.** What distinguishes a casual gambler from a professional gambler?
- IV.** What method does the Department accept for a casual gambler's calculation of gambling income?
- V.** What responsibility does a gambler have to document gambling activity and maintain records to support items reported on income tax returns?

CONCLUSIONS

- I.** Gambling income is wagering income earned from gambling activity whether legal or illegal, including but not limited to bingo, lotteries, raffles, pari-mutuel wagering (such as horse-racing, dog-racing and jai-alai), casino gaming (including table games such as blackjack, craps, roulette, and electronic gaming such as slots and video poker), and internet gambling, as well as the fair market value of all prizes or complimentary items such as cars, trips, or lodging. It is not limited to amounts reported by gambling establishments on W-2G forms. Gambling income does not include cash or prizes paid to a winner of a game or drawing that does not include a wager, such as "no purchase necessary" drawings and prizes based on correctly answering a quiz. Non-wager income is generally taxable, but is not addressed in this RAB.
- II.** All gambling income from any source whatsoever is subject to tax and is a component of adjusted gross income (AGI). Since the classification of losses as business or non-business affects the calculation of AGI, the Department's treatment of wagering losses depends upon the proper reporting of those losses at the federal level. Professional gamblers engaged in the trade or business of gambling may deduct wagering losses as part of the calculation of gross income at the federal level. For professional gamblers, deducting losses reduces AGI, which flows through to the Michigan return. Casual gamblers may only deduct wagering losses at the federal level by itemizing, which does not flow through to the Michigan return. As a result, a casual gambler does not receive the tax benefit of wagering losses on the Michigan return that is received on a federal return. At the federal level, both professional and casual gamblers may only deduct wagering losses to the extent of wagering gains. On the Michigan return, professional gamblers' losses are recognized to the extent that the losses are part of AGI, but casual gamblers may not deduct losses except as described in this RAB.
- III.** A taxpayer is engaged in the trade or business of gambling and is thus a professional gambler if the taxpayer pursues the activity with continuity and regularity and for the primary purpose of producing income or profit. A casual gambler engages in the activity sporadically, as a hobby or for amusement. The Department will examine all relevant facts and circumstances to determine whether a taxpayer has properly characterized his or her status as a professional or casual gambler and whether the gambling income (wagering gains and wagering losses) is properly reported.
- IV.** The Department accepts the session method for purposes of computing a casual gambler's gambling income resulting from electronic slot machine course-of-play wagering transactions and other casino games. A session begins when a gambler places the first wager and ends when the same gambler completes his or her last wager on the same game

type before the end of the same calendar day at the same gambling establishment. Casual gamblers may not net session wins and losses against one another.

- V. Both professional and casual gamblers must keep records sufficient to verify wagering gains and wagering losses. An accurate diary or other daily record should be maintained. A professional gambler who deducts wagering losses on his or her return must be able to provide receipts, tickets, statements or other records showing the amount of wagering gains and losses. Statements generated by gambling establishments and provided to the gambler are insufficient by themselves to document a gambler's total wagering gains and losses.

LAW AND ANALYSIS

Definitions. For purposes of this RAB:

“Course-of-play” means a series of transactions marked by gains and losses that occur during a session of play.

“Gambling winnings” or “payout” have two components: wagering gains and the wager (bet). Wagering gains, but not the wager, are included in gambling income. The wager is not gambling income because it is a nontaxable return of capital. A prize paid to a winner that is not based on a wager is not gambling winnings although it may otherwise be taxable income.

“Gambling income” for a professional gambler is wagering gains less wagering losses. Wagering losses are limited to the amount of wagering gains.

“Gambling income” for a casual gambler is wagering gains. Gambling income for a casual gambler does not include wagering losses except those incurred during the course-of-play of a gambling session as described in this RAB. For casual gamblers, wagering gain is calculated on a per-session basis and course-of-play losses may offset course-of-play gains.

“Session” means the period of time beginning when a gambler places the first wager and continues until the same gambler completes his or her last wager on the same game type before the end of the same calendar day at the same gambling establishment.

“Wagering loss” is the loss of the wager. For professional gamblers and most casual gamblers, wagering losses are calculated after each wager except for casual gamblers using the per-session calculation method as permitted by this RAB. For casual gamblers, a “wagering loss” occurs if, at the end of a session, the total amount of wagers placed during the session (course-of-play wagers) exceed the end of session payout. That is, a wagering loss occurs when a casual gambler has ended the session with less money than when he or she began the session.

Terms	Professional Gambler	Casual Gambler
Gambling winnings (payout)	Wagering gains and the wager.	Wagering gains and the wager.

Terms	Professional Gambler	Casual Gambler
Gambling income	Wagering gains less wagering losses (cannot be less than zero).	Wagering gains. Does not include wagering losses except course-of-play losses incurred during a session. Wagering gains occur if the casual gambler ends a session of play with more money than when he started the session.
Wagering loss	Loss of the wager. Reduces gambling income. For a professional gambler, the wagering loss is calculated on each wager transaction (not course-of-play).	Loss of the wager. Does not reduce gambling income. Wagering losses are not the same as course-of-play losses. Course-of-play losses may offset course-of-play winnings during a session of game play. Wagering losses occur if the casual gambler ends a session with less money than when the session began.
Course-of-play	Does not apply to professional gamblers.	Gains and losses that occur during a session of play. Course-of-play gains and losses may be netted. At the end of a session, after netting, the casual gambler will have either a wagering gain or a wagering loss from the session. Gains or losses from separate sessions may not be netted against each other to determine gain or loss for a tax year.

Types of gambling activity. Neither the Internal Revenue Code (IRC) nor the Michigan Income Tax Act (MITA) define gambling. According to the Internal Revenue Service (IRS), gambling activity includes but is not limited to: wagering gains from lotteries; raffles; pari-mutuel wagering, including horse-racing, dog racing and jai-alai; casino gaming, which includes table games such as blackjack, craps, roulette and their variations, electronic gaming including slots, video poker and other video and internet gambling; and, the fair market value of prizes or other complimentary items such as cars and trips.¹ All wagering gains from gambling are income even if the amount of the wagering gains are below the level that requires the payer to report the income to the IRS. Gambling income is not limited to wagering gains derived from legal activities.²

¹ See IRS Topic 419 Gambling Income and Losses and IRS Publication 525.

² See *James v United States*, 366 US 213, 215 (1961) where embezzled funds were included in gross income.

Reporting gambling income on a federal return. The proper characterization of gambling income at the federal level is important because the starting point for determining Michigan taxable income is federal adjusted gross income.³

Wagering gains are included in gross income and therefore must be reported on a taxpayer's federal tax return.⁴ The only component of gambling winnings that a federal taxpayer may exclude from gross income is the winning wager (bet), which is a nontaxable recovery of capital.⁵ For example, if a \$2 wager results in a \$10 gambling winnings or payout, the gambling income is the wagering gain of \$8. The remaining \$2 (the wager or bet) is a tax-free return of capital.⁶

Wagering losses are deductible at the federal level in one of two ways.⁷ For professional gamblers, wagering losses incurred in connection with the operation of a trade or business are reported on U.S. Form 1040, Schedule C, where they may be used to offset wagering gains. Wagering losses on a schedule C cannot reduce wagering gains below zero. The net income of a professional gambler reported on schedule C is a component of the taxpayer's adjusted gross income.⁸

Wagering losses incurred by casual gamblers do not qualify as a trade or business loss and must be reported, if at all, on U.S. Form 1040, Schedule A as an itemized deduction and therefore do not figure into the calculation of a taxpayer's AGI. Wagering losses reported on Schedule A are "below-the-line" deductions.⁹ Casual gamblers are prohibited from netting wagering gains against wagering losses with the exception of per-session netting. Both professional and casual gamblers may only deduct wagering losses on the federal return to the extent of wagering gains.¹⁰ Neither may carry over excess wagering losses to offset wagering gains in another taxable year or to offset non-wagering income.¹¹

Non-wagering business expenses incurred by professional gamblers may be deducted at the federal level. Non-wagering business expenses may include transportation, meals and entertainment, lodging, admission fees, mailing, printing, subscriptions, and other fees. Trade or business expenses incurred in the conduct of the trade or business of gambling, other than the cost of wagers, are not limited to the amount of the gambling gains.¹²

Reporting gambling income on a Michigan return. The Michigan Income Tax Act's use of AGI from the federal return as a starting point in computing Michigan income tax means that the wagering gains of both professional and casual gamblers are reflected on the Michigan return, but only the professional gambler's federally deductible losses carry over to the Michigan return because the losses are a component of the professional gambler's trade or business income and

³ MCL 206.30(1).

⁴ Rev Rul 54-339, 1954-2 CB 89.

⁵ *Shollenberger v Commissioner of Internal Revenue*, 98 TCM 667, 669 (2009).

⁶ 33A AmJur2d Federal Taxation § 13258.1 (2005).

⁷ *Byrd v Hamer*, 943 NE2d 115, 120 (2011).

⁸ *Id.*, citing 26 USC § 62(a)(1).

⁹ *Byrd*, *supra*, citing *LaPlante v Commissioner of Internal Revenue*, TC Memo 2009-226.

¹⁰ IRC 165(d).

¹¹ *Skeeles v United States*, 118 Ct Cl 362 (1951), cert denied, 341 US 948 (1951).

¹² See *Mayo v Commissioner of Internal Revenue*, 136 TC 81 (2011), overruling *Offutt v Commissioner of Internal Revenue*, 16 TC 1214 (1951).

therefore the losses are included in AGI.¹³ However, a casual gambler may only report wagering losses as federal itemized deductions, which are not included in AGI and therefore do not carry over to the Michigan return. MITA contains no subtraction from AGI for casual wagering losses on the Michigan return; therefore a casual gambler may not deduct his or her wagering losses to arrive at Michigan taxable income.¹⁴

Allocation and apportionment of gambling income. A professional gambler who has winnings from activity both in-state and out-of-state must apportion the income based on the sales factor, the numerator of which is the gambling winnings in Michigan and the denominator of which is all gambling winnings.¹⁵ Gambling winnings are the wager plus the wagering gains. Casual gamblers who are residents of Michigan must allocate all gambling income to Michigan.¹⁶ A Michigan resident may claim an income tax credit if the gambling income is subject to income tax in another state. Casual gamblers who are not residents of Michigan are subject to income tax on the gambling income earned in Michigan. Casual gamblers may not apportion their gambling income.¹⁷

Establishing professional gambler status. A taxpayer is engaged in the trade or business of professional gambling if he or she is involved in the activity with continuity and regularity and with the primary purpose of earning income or profit.¹⁸ Since a taxpayer has the burden of establishing entitlement to deductions, the taxpayer has the burden of proving professional gambler status.¹⁹ The Department will consider all of the facts and circumstances in determining whether a taxpayer has established professional gambler status.

Continuity and regularity is not established by simply adding up the hours spent gambling during a year and averaging them on a weekly basis.²⁰ A taxpayer must demonstrate that he or she engaged in the activity constantly, continually, steadily, sustainably and in a methodical way.²¹

Establishing a profit motive requires more than a mere statement by the taxpayer of his or her intent to make a profit; greater weight is given to objective facts and circumstances than to the taxpayer's stated intent.²² The following non-exhaustive list of factors prepared by the IRS bears on a determination of a taxpayer's profit objective:²³

- (1) The manner in which the taxpayer carries on the activity, including whether the taxpayer maintains complete and accurate books and records.
- (2) The expertise of the taxpayer or his advisors regarding the accepted business or economic practices for engaging in the activity and the taxpayer's effort to carry on the activity in accord with those accepted practices.

¹³ See MCL 206.30(1).

¹⁴ *Menard Inc v Dep't of Treasury*, 302 Mich App 467, 473 (2013).

¹⁵ MCL 206.115(2) and 206.20(1).

¹⁶ MCL 206.110(1).

¹⁷ MCL 206.110(2)(d).

¹⁸ *Commissioner of Internal Revenue v Groetzinger*, 480 US 23, 35 (1987).

¹⁹ *Menard Inc. v Dep't of Treasury*, 302 Mich App 467, 473 (2013).

²⁰ See *Erbs v Commissioner of Internal Revenue*, TC Summ Op 2001-85.

²¹ See *Free-Pacheco v United States*, 117 FedCl 228, 263 (FedCl 2014).

²² *Hastings v Commissioner of Internal Revenue*, 84 TCM 663 (2002).

²³ The list applies generally to any trade or business and some items on the IRS list may have less application to a gambling trade or business. 26 CFR § 1.183-2(b).

(3) The time and effort expended by the taxpayer in carrying on the activity, including whether the taxpayer devotes most of his energies to the gambling activity or to another occupation.

(4) The expectation that assets used in the activity may appreciate in value.

(5) The success of the taxpayer in carrying on other similar or dissimilar activities and specifically whether a taxpayer has successfully converted other similar enterprises from unprofitable to profitable even though the activity is currently unprofitable.

(6) The taxpayer's history of income or losses with respect to the activity. Sustained losses not due to customary business risks or extraordinary circumstances are indicative of an activity not conducted for profit.

(7) The amount of occasional profits, if any, which are earned, and specifically the amount of profits in relation to the amount of losses.

(8) The financial status of the taxpayer, including whether the taxpayer has substantial income from other sources, particularly where the losses from the activity provide substantial tax benefit by reducing the income from other sources.

(9) The elements of personal pleasure or recreation derived from the activity.

Proper classification of losses at the federal level has far more significance to the calculation of Michigan taxable income than to the calculation of federal taxable income, which permits a deduction to both professional and casual gamblers.²⁴ Therefore, the Department is not bound by the IRS' apparent acceptance of the taxpayer's return claiming professional gambler status, and will make its own determination whether a taxpayer has properly reported gambling losses as either a professional or casual gambler.²⁵

Casual gamblers and per-session calculation of income. Casual gamblers are generally prohibited from netting their wagering gains and losses; however, the IRS specifically allows a casual gambler to net course-of-play gains and losses from electronic slot machine wagering transactions on a per-session basis under a recently proposed safe harbor rule.²⁶ Under the proposed IRS safe harbor rule for casual gamblers, a session of play begins when a patron places the first wager on a particular type of game and ends when the same patron completes his or her last wager on the same type of game before the end of the same calendar day at the same establishment. The time is determined by the time zone of the location where the patron places the wager. A session of play is always determined with reference to a calendar day (24-hour period from 12:00 a.m. through 11:59 p.m.) and ends no later than the end of that calendar day.

Session reporting allows a casual gambler to net course-of-play gains from a session with course-of-play losses from that same session. If at the end of the session, the casual gambler has more

²⁴ See *Mertz v Michigan Dep't of Treasury*, MTT Docket No. 240435, fn 7, wherein the Michigan Tax Tribunal noted that the IRS was indifferent to whether the taxpayer claimed losses as a professional or a casual gambler because in either case the federal taxable income was the same.

²⁵ *Maxitrol Co. v Dep't of Treasury*, 217 Mich App 366, 372 (1996).

²⁶ See IRS Notice 2015-21 Safe Harbor Method for Determining a Wagering Gain or Loss from Slot Machine Play, citing *Shollenberger v Commissioner of Internal Revenue*, TC Memo 2009-306 (2009).

money than at the start of the session, the gambler has wagering gains. If at the end of the session, the casual gambler has less money than at the start, the casual gambler has a wagering loss. The net gambling income from a session can never be less than zero. The Department will accept the IRS's per-session reporting method for not only slot machine play but for all other casino games.

Example 1. A casual gambler begins slot machine play at Casino X at 2 p.m. and plays several machines until breaking for dinner at 6 p.m. He returns to slot machine play at Casino X again at 8 p.m. and plays several machines until 1 a.m. when he then drives to Casino Y, arriving at 2 a.m. and playing several more slot machines until 4 a.m. He then plays blackjack from 4 a.m. to 6 a.m. while still at Casino Y. The gambler's same-day play at Casino X from 2 p.m. to 6 p.m. and from 8 p.m. until midnight constitutes a single session of play. The play from midnight until 1 a.m. constitutes a second session because it is a different day, and the play from 2 a.m. to 4 a.m. at a different casino constitutes a third session of play. The play from 4 a.m. to 6 a.m. constitutes a fourth session of play because the type of game changed from slots to blackjack.

A casual gambler recognizes net gambling income if at the end of a single session of play the total payout (gambling winnings) exceeds the total amount of course-of-play wagers placed during the session. That is, the casual gambler ends the session with more money than at the start. A casual gambler recognizes gambling income of zero if at the end of a single session of play the total amount of course-of-play wagers placed during the session exceeds or is equal to the total payout from the slot machines played during that session.

Example 2. Assume the same facts as in Example 1. From 2 p.m. until 6 p.m. the casual gambler had course-of-play wagers of \$600 and total payouts of \$800 (exceeding his wagers by \$200). From 8 p.m. until midnight (the second half of the same session), he placed wagers of \$560 and won \$500, creating a net loss of \$60. The casual gambler may net his \$200 gain and his \$60 loss because they occurred in a single session.

Session 1: 2:00 p.m. to Midnight Casino X	
Payout	$\$800 + \$500 = \$1,300$
Wagers	$\$600 + \$560 = (1,160)$
Gambling income	\$ 140

From midnight until 1 a.m. the casual gambler had wagers of \$1,300 and payouts of \$1,000, the wagers exceeding payouts by \$300. Gambling income is zero because net gambling income from a session can never be less than zero.

Session 2: Midnight to 1:00 a.m. Casino X	
Payout	\$1,000
Wagers	(1,300)
Gambling Income	\$ 0

From 2 a.m. to 4 a.m. the casual gambler had wagers of \$850 and payouts of \$700. His wagers exceeded his payouts by \$150. Gambling income is zero because net gambling income from a session can never be less than zero.

Session 3: 2:00 a.m. to 4:00 a.m. Casino Y	
Payout	\$700
Wagers	(850)
Gambling Income	\$ 0

From 4 a.m. to 6 a.m. the casual gambler had wagers of \$650 and payouts of \$900. His payouts exceeded his wagers by \$250. Gambling income is \$250. The casual gambler may not net his session 3 slot machine loss against his session 4 blackjack gain even though they occurred on the same day and at the same casino, because the gain and loss occurred in connection with two separate types of games.

Session 4: 4:00 a.m. to 6:00 a.m. Casino Y	
Payout	\$900
Wagers	(650)
Gambling Income	\$ 250

At the end of the year, if the casual gambler gambled on no other days during the year, he will have gambling income reported in AGI of \$390.

The IRS has no published guidance extending this per-session calculation of gambling income to gambling other than slot machine play. However, the rationale for netting wagering losses against wagering gains from the same session derives from IRC 165(d), which refers to wagering transactions in the plural. The IRS has interpreted IRC 165(d) to mean that gain or loss may be calculated over a series of separate plays or wagers because fluctuating wins and losses left in play are not accessions to wealth until a taxpayer can definitively calculate the amount above or

below basis that the taxpayer realized.²⁷ Though lacking any formal IRS guidance, courts have interpreted the IRS's position to extend to other casino games in which it is impractical and burdensome to track gains on a per-bet basis.²⁸ The Department agrees with and follows this interpretation of IRC 165(d) and accepts per-session reporting for all casino games. Acceptance of per-session reporting does not mean that a casual gambler may offset separate session winnings earned throughout the year with separate losses incurred throughout the year as does a professional gambler.²⁹ Furthermore, the Department's acceptance of per-session reporting does not mean that the Department necessarily accepts the taxpayer's claim of professional gambler status on the federal return. In fact, per-session reporting does not apply to professional gamblers because they are permitted to net wagering gains and losses incurred throughout the year.

Gambler's obligation to keep records. The IRC generally requires any payer of gambling winnings of \$600 or more to report that information. This reporting threshold is increased to \$1,200 for bingo and slot machine winnings and \$1,500 for keno games.³⁰ Bingo, keno, and slot machine winnings are reported on Form W-2G, Certain Gambling Winnings.

A gaming establishment's duty to report gambling winnings above these thresholds, or any other threshold determined in the future, does not mean that gambling income from gambling wagers below these thresholds are nontaxable. All gambling income is subject to tax. Therefore, a taxpayer is obligated to keep and maintain accurate records from which the Department can determine the tax due.³¹ Form W-2Gs alone are insufficient to prove either a gambler's status as a professional gambler or the amount of wagering gains and losses claimed on a return.³² Acceptable evidence for substantiation of wagering gains and losses includes an accurate diary or similar record regularly and contemporaneously maintained by the taxpayer, supplemented by verifiable documentation.³³

Diaries, journals, or other self-generated records should contain at a minimum the date and type of specific wager or wager activity, the name and address of the gambling establishment, the machine or table number played, the amount won or lost during each session, and the name of any other persons present with the taxpayer at the gambling establishment. Verifiable documentation used to supplement the self-generated record includes but is not limited to casino generated forms such as Form W-2G, wagering tickets, canceled checks, a taxpayer's casino credit or check-cashing records, bank deposit and withdrawal statements, payment slips, winnings statements, hotel bills, and airline tickets.³⁴

²⁷ See *Shollenberger v Commissioner of Internal Revenue*, TC Memo 2009-306, p 1 (2009), citing IRS Chief Counsel Advice 2008-011 (Dec 5, 2008).

²⁸ See *Park v Commissioner of Internal Revenue*, 722 F.3d 384, 386-387 (2013). The *Park* case involved a slot machine player, but the Court's analysis clearly interpreted the IRS's position and its accession to wealth rationale to apply to casino games other than just slot machines.

²⁹ *Shollenberger*, *supra* at p 2.

³⁰ 26 CFR § 7.6041-1.

³¹ MCL 205.408.

³² W-2Gs are insufficient proof of gambling income because they only document winnings above a certain threshold and do not track losses at all. Additionally, W-2Gs are inadequate to prove professional gambling status because professionals conducting a trade or business do not rely solely on records generated by others to track business operations and such records cannot establish the regularity or continuity of a gambler's activities.

³³ See Rev Proc 77-29, 1977-2 CB 538.

³⁴ *Id.*